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No. 234

In the Supreme Court of the United States

OCTOBER TERM, 1960

THE DIXIE, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Argument	4
Conclusion	8
Appendix	9

CITATIONS

Cases:

Comstock v. *Group of Investors*, 335 U.S. 211	6
Corn Products Co. v. *Commissioner*, 350 U.S. 46	6
Helvering v. *Chicago Stock Yards Co.*, 318 U.S. 693	5
Helvering v. *Nat. Grocery Co.*, 304 U.S. 282	5
I. A. Dress Co. v. *Commissioner*, 273 F. 2d 543, certiorari denied 362 U.S. 976	4, 7
Smoot Sand & Gravel Corp. v. *Commissioner*, 274 F. 2d 495, certiorari denied, 362 U.S. 976	4, 7
Smoot Sand & Gravel Corp. v. *Commissioner*, decided December 31, 1958 (T.C.)	7
Smoot Sand & Gravel Corp. v. *Commissioner*, 241 F. 2d 197, certiorari denied, 354 U.S. 922	7

559897 60

Statutes:

Internal Revenue Code of 1939: Page

Sec. 102 (26 U.S.C. 1952 ed., Sec. 102) ... 4, 5, 9

Sec. 102(a) (26 U.S.C. 1952 ed., Sec. 102(a)) ... 2, 5, 9

Sec. 102(c) (26 U.S.C. 1952 ed., Sec. 102(c)) ... 2, 5, 6, 9

Internal Revenue Code of 1954:

Sec. 534 (26 U.S.C. 1958 ed., Sec. 534) ... 6, 10

Sec. 534(a) (26 U.S.C. 1958 ed., Sec. 534(a)) ... 2, 10

Sec. 534(b) (26 U.S.C. 1958 ed., Sec. 534(b)) ... 2, 10

Sec. 534(c) (26 U.S.C. 1958 ed., Sec. 534(c)) ... 2, 10

Sec. 534(e) (26 U.S.C. 1958 ed., Sec. 534(e)) ... 2, 11

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. A5–A32)[1] are reported in 31 T.C. 415. The opinion of the Court of Appeals (Pet. 23–27) is reported at 277 F. 2d 526.

JURISDICTION

The judgment of the Court of Appeals was entered on April 14, 1960. (Pet. 1.) The petition for a writ of certiorari was filed on July 13, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] Record references are to the appendix to the taxpayer's brief, separately bound, filed in the Court of Appeals.

QUESTION PRESENTED

Whether the two courts below were correct in finding that during 1952 the taxpayer was availed of for the purpose of avoiding surtax upon its shareholders by means of permitting earnings and profits to accumulate and, therefore, is liable for the surtax imposed by Section 102 of the Internal Revenue Code of 1939.

STATUTES INVOLVED

The pertinent portions of Section 102 (a) and (c) of the Internal Revenue Code of 1939, and Section 534 (a) (1) and (2), (b), (c) and (e) (1) and (2) of the Internal Revenue Code of 1954 are set out in the Appendix, *infra*, pp. 9–11.

STATEMENT

The facts as found by the Tax Court (R. A5–A26), and as stated by the Court of Appeals (Pet. 23–25), may be summarized as follows:

The taxpayer is a corporation which was organized under the laws of the State of New York in 1942, and at all times pertinent hereto has been engaged in the operation of the Hotel Dixie in New York City. (R. A5–A6.) The company has been wholly owned by Hyman B. Cantor since its creation. (R. A7.) The premises of the Hotel Dixie are owned by King Hotels, Incorporated (hereinafter referred to as King), similarly organized in 1942 and wholly owned by Cantor and his wife. Carter Hotels Operating Corporation (hereinafter referred to as Carter) was organized in 1941 under the laws of New York and

was wholly owned by Cantor and his wife. Carter served as renting and managing agent for the Hotel Dixie and for the hotels Essex, Avery, and George Washington, each of which was both owned and operated by a Cantor-owned corporation. (R. A6.) At all times pertinent hereto Cantor was president and treasurer of the taxpayer, and also of Carter and King; his wife was assistant secretary of the same companies. The third officer of the taxpayer, the vice-president and secretary, was replaced from time to time, but while he was vice-president and secretary of the taxpayer he held the same office in Carter and King. (R. A15.)

When the taxpayer was organized in 1942, Cantor paid $1,000 for all of its stock. (R. A5–A6, A7.) By 1952, the taxable year, its accumulated surplus was about $708,000, and after 1952 it continued to accumulate all of its earnings and profits. During the taxpayer's entire existence it never declared a dividend. (R. A21.) For the year 1952 the taxpayer reported a normal tax and surtax net income in the amount of about $155,000, and an income tax liability in the amount of about $75,000. After the payment of the above tax the taxpayer retained the balance of its net income, about $80,000. (R. A6.) If the taxpayer's earnings for 1952 had been distributed to Cantor, its sole stockholder, his additional surtax liability would have been about $60,000. (R. A21.)

On October 4, 1955, the Commissioner notified the taxpayer that a deficiency was to be proposed pursuant to Section 102 with respect to the accumulation

of $80,193.14 in the year 1952, and gave the taxpayer time to file the statement provided by Section 534 of the Internal Revenue Code of 1954. On October 31, 1955, the taxpayer submitted to the Commissioner a statement in which it purported to set forth grounds for the accumulation of surplus. (R. A22.) On January 17, 1956, the Commissioner notified the taxpayer of a determination of a deficiency in income taxes for the year 1952 pursuant to Section 102 of the 1939 Code. (R. A26.). The taxpayer filed a petition with the Tax Court, which found that during the year 1952 the taxpayer was availed of for the purpose of avoiding surtax upon its shareholders (R. A26), and accordingly entered a decision against the taxpayer (R. A4). Thereupon, the taxpayer appealed to the Court of Appeals for the Second Circuit, which decided that the Tax Court's determination was supported by the record and not clearly erroneous, and should be affirmed. (Pet. 23–27.)

ARGUMENT

The narrow factual issue here presented does not warrant further review. At the last term the Court declined to review two cases involving the application of Section 102 of the Internal Revenue Code of 1939 to factual situations generally similar to that here. *I. A. Dress Co.* v. *Commissioner*, 273 F. 2d 543 (C.A. 2d), certiorari denied, 362 U.S. 976; *Smoot Sand & Gravel Corp.* v. *Commissioner*, 274 F. 2d 495 (C.A. 4th), certiorari denied, 362 U.S. 976.

The purpose of Section 102 of the 1939 Code (Appendix, *infra*, pp. 9–10) is to compel a corporation to distribute its earnings and profits so that individual stockholders will become liable for tax on the dividends received. *Helvering* v. *Chicago Stock Yards Co.*, 318 U.S. 693, 699. Accordingly, subsection (a) of Section 102 (Appendix, *infra*, p. 9) imposes a surtax on a corporate taxpayer if one of its purposes for accumulating earnings and profits was to avoid the imposition of tax upon its shareholders. The taxpayer, under principles applicable in income tax cases generally, has the burden of disproving the Commissioner's findings. Indeed, subsection (c) of Section 102 (Appendix, *infra*, pp. 9–10) provides that, if an accumulation is beyond the reasonable needs of the business, that fact increases the taxpayer's burden so that it must then disprove the proscribed purpose by a clear preponderance of the evidence. These are, of course, questions of fact and the trial court's findings are sustained unless clearly erroneous. *Helvering* v. *Chicago Stock Yards Co.*, *supra*, p. 700; *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282, 295.

The Tax Court found that the taxpayer's earnings and profits for the year 1952 were accumulated beyond the reasonable needs of its business (R. A31–A32), and that this was done for the purpose of preventing the imposition of surtax upon Cantor, its sole stockholder (R. A7, A26, A32). The court below, after reviewing the evidence, held that there was ample support in the record for the Tax Court's finding

that the taxpayer was availed of for the purpose of avoiding surtax upon its shareholder (Pet. 24), and that the findings are not clearly erroneous (Pet. 27).[1] The concurrent findings of fact by the two courts below are entitled to finality here. *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 51; *Comstock* v. *Group of Investors*, 335 U.S. 211, 214.

Some of the factors which support the findings below are: the taxpayer has never declared a dividend though it was successful and had accumulated more than $708,000 by the year 1952 (R. A21); Cantor, the sole stockholder (R. A7), was aware of the fact that if he distributed earnings of the taxpayer to himself, he would have incurred a large additional tax liability (R. A21; Tr. 101);[2] as a result of the taxpayer's never having declared a dividend, the accumulated earnings and profits increased to more than $708,000 (R. A21); the taxpayer's accumulated earnings were held for the convenience of Cantor (Pet. 25); the accumulated earnings were not, so far as the record shows, formally devoted to any specific purpose; and the alleged plans for remodeling the basement of the

[1] Indeed, the court below found such ample support in the record, however viewed, for the finding of the Tax Court that it was deemed unnecessary to determine the limitations of the statutory presumption set out in Section 1(24(c) of the 1939 Code or to involve the determination of the case with the niceties of burden of proof indicated in Section 534 of the 1954 Code (Appendix, *infra*, pp. 10-11). (Pet. 16-20, 24.)

[2] "Tr." references are to the portions of the testimony printed in Appendix B of the Commissioner's brief filed in the court below, which has been filed as part of the record before this Court.

Hotel Dixie or of purchasing another hotel in the vicinity of the taxpayer were vague and indefinite (R. A16-A18, A29-A31).

Contrary to the taxpayer's contention (Pet. 14-15), the decision below plainly is not in conflict with the decision of the Fourth Circuit in *Smoot Sand & Gravel Corp.* v. *Commissioner*, 241 F. 2d 197, certiorari denied, 354 U.S. 922. That case turned upon its particular facts with respect to the amount of working capital there required; and, indeed, no rule or formula applicable to all cases with respect to the amount of working capital required was laid down by the Fourth Circuit upon its eventual disposition of the litigation after remand to the Tax Court. *Smoot Sand & Gravel Corp.* v. *Commissioner*, decided December 31, 1958 (1958 P-H T.C. Memorandum Decisions, par. 58,221), affirmed, 274 F. 2d 495 (C.A. 4th), certiorari denied, 362 U.S. 976. Nor is there any conflict here with the Fourth Circuit's observation in its first opinion in the *Smoot Sand & Gravel Corp.* case (241 F. 2d 197, 206) that a contingency is a reasonable need for which a business may provide, if the likelihood, not merely the possibility, of its occurrence reasonably appears. (Pet. 15.) The court below held only that the mere recognition of a business need is not enough; in order to justify an accumulation as reasonable, the need must be treated with definiteness of plan coupled with action taken toward its consummation. (Pet. 25-26.) *I.A. Dress Co.* v. *Commissioner*, 273 F. 2d 543 (C.A. 2d), certiorari denied, 362 U.S. 976.

CONCLUSION

The petition for certiorari should be denied.
Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1939:

SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

(a) [As amended by Sec. 103(d), Revenue Act of 1941, c. 412, 55 Stat. 687] *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year (in addition to other taxes imposed by this chapter) upon the net income of every corporation (other than a personal holding company as defined in section 501 or a foreign personal holding company as defined in Supplement P) if such corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed, a surtax equal to the sum of the following:

27½ per centum of the amount of the undistributed section 102 net income not in excess of $100,000, plus

38½ per centum of the undistributed section 102 net income in excess of $100,000.

* * * * *

(c) *Evidence Determinative of Purpose.*—The fact that the earnings or profits of a corporation are permitted to accumulate beyond the reasonable needs of the business shall be determinative of the purpose to avoid surtax upon shareholders unless the corporation by the clear

preponderance of the evidence shall prove to the contrary.

* * * * *

(26 U.S.C. 1952 ed., Sec. 102.)

Internal Revenue Code of 1954:

SEC. 534. BURDEN OF PROOF.

(a) *General Rule.*—In any proceeding before the Tax Court involving a notice of deficiency based in whole or in part on the allegation that all or any part of the earnings and profits have been permitted to accumulate beyond the reasonable needs of the business, the burden of proof with respect to such allegation shall—

(1) if notification has not been sent in accordance with subsection (b), be on the Secretary or his delegate, or

(2) if the taxpayer has submitted the statement described in subsection (c), be on the Secretary or his delegate with respect to the grounds set forth in such statement in accordance with the provisions of such subsection.

(b) [As amended by Sec. 5 of the Act of August 11, 1955, c. 805, 69 Stat. 689] *Notification by Secretary.*—Before mailing the notice of deficiency referred to in subsection (a), the Secretary or his delegate may send by registered mail a notification informing the taxpayer that the proposed notice of deficiency includes an amount with respect to the accumulated earnings tax imposed by section 531. In the case of a notice of deficiency to which subsection (c)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day.

(c) *Statement by Taxpayer.*—Within such time (but not less than 30 days) after the mailing of the notification described in subsection

(b) as the Secretary or his delegate may prescribe by regulations, the taxpayer may submit a statement of the grounds (together with facts sufficient to show the basis thereof) on which the taxpayer relies to establish that all or any part of the earnings and profits have not been permitted to accumulate beyond the reasonable needs of the business.

* * * * *

(e) [as amended by Sec. 4 of the Act of August 11, 1955, *supra*] *Application of Section.*—

(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of proceedings tried on the merits after the date of the enactment of this paragraph.

(26 U.S.C. 1958 ed., Sec. 534.)